



Edward T. Tilly
President and Chief Operating Officer

Phone: 312 786-7088
Fax: 312 786-7407
tillye@cboe.com

August 27, 2012

Via Electronic Mail

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
rule-comments@sec.gov

Re: File No. SR-ISE-2012-22

Dear Ms. Murphy:

Chicago Board Options Exchange, Incorporated (“CBOE”) hereby submits comments in response to the letter of the International Securities Exchange, LLC (“ISE”),¹ which addressed the questions identified by the U.S. Securities Exchange Commission (the “Commission”) in its order instituting proceedings (the “OIP”)² as to whether to disapprove ISE’s proposed rule change, rule filing number SR-ISE-2012-22 (the “ISE Proposal”).³

The ISE OIP Letter mostly repeats arguments that ISE made in its previous comment letters, so those arguments have been adequately addressed in CBOE’s letter responding to the OIP⁴ (the “CBOE OIP Letter”) and need not be repeated here. However, the ISE OIP letter contains startling new and troubling information about the staleness of the data ISE purportedly would use to calculate the settlement value of the Proposed Options,⁵ and this information highlights additional ways in which the ISE Proposal would confuse investors.

From the beginning of the comment process, CBOE has expressed concern that ISE was misleading and confusing investors about how it would calculate the settlement value of the Proposed Options.⁶ Only in its second comment letter did ISE finally provide some concrete

¹ Letter from Michael J. Simon, Secretary and General Counsel, ISE, dated August 10, 2012 (the “ISE OIP Letter”).

² See Securities Exchange Act Release No. 67225 (June 20, 2012), 77 FR 38100 (June 26, 2012) (order instituting proceedings to determine whether to approve or disapprove proposed rule change).

³ See Securities Exchange Act Release No. 66614 (March 16, 2012), 77 FR 16883 (March 22, 2012) (noticing SR-ISE-2012-22).

⁴ Letter from Edward T. Tilly, President and Chief Operating Officer, CBOE, dated August 10, 2012.

⁵ This rebuttal comment letter uses the same defined terms that were used in the CBOE OIP Letter.

⁶ See CBOE Letter I at 5-7 and CBOE Letter II at 3-4.

information about how it purportedly would make that calculation.⁷ In response, CBOE pointed out that it would be impossible for ISE to base its calculation on the claimed data, because the data would not even be available to ISE until after the 6 p.m. deadline by which ISE reported it would need to communicate the final settlement value to OCC.⁸ In trying to blunt this criticism, ISE claimed for the first time, in the ISE OIP Letter, that it would “compute its net asset value (‘NAV’) of the SPY ETF” based on data “distributed *from the prior night* by the National Securities Clearing Corporation.”⁹ In other words, although the settlement value of the Proposed Options would be determined on expiration Friday, the calculation of that value would utilize data inputs from the end of trading on expiration *Thursday*.

This revelation raises serious new concerns about investor confusion. For instance, ISE’s approach would directly contradict the settlement value formula that ISE provided the Commission in ISE Letter II. That formula states that the “ISE Max SPY settlement value at time (t)” would equal 10 times the “Net Asset Value per share of SPDR[®] S&P500[®] ETF Trust . . . at time (t).”¹⁰ In other words, the settlement value calculation was to utilize data inputs from the same day as the settlement value calculation – namely, time (t), which would be expiration Friday.¹¹ But ISE has now revealed that it plans to utilize data inputs from *Thursday* – *i.e.*, time (t-1) – to calculate the NAV upon which the settlement value of the Proposed Options supposedly would be based. This means that ISE’s formula once again is revealed as a confusing and internally inconsistent description of ISE’s professed plans, a description that continuously shifts as ISE struggles to describe how it would calculate the settlement value of the Proposed Options.¹²

In addition, ISE’s plan to use stale data would result in investor confusion about ISE’s NAV calculation. The key inputs into ISE’s settlement value formula purportedly would be the number of shares of each stock held by the Trust, the closing price for each of those stocks, and the cash held in the Trust.¹³ Because ISE would use day-old information, at least two of those inputs would be out-of-date and potentially incorrect, which could cause ISE’s calculation of the NAV of the Trust on expiration Friday to deviate significantly from the actual NAV.¹⁴ For

⁷ See ISE Letter II at 2-3.

⁸ See Letter from Edward T. Tilly, President and Chief Operating Officer, CBOE, dated June 19, 2012, at 1-2.

⁹ See ISE OIP Letter at 2 (emphasis added).

¹⁰ ISE Letter II at 2.

¹¹ See Securities Exchange Act Release No. 66614 (March 16, 2012), 77 FR 16883 (March 22, 2012) (noticing SR-ISE-2012-22) at 16885 (expiring Proposed Options “will cease trading at 4 p.m. (EST) on the Friday preceding an expiration Saturday”).

¹² CBOE has demonstrated various other ways that ISE’s formula is vague, incomplete and internally inconsistent. See CBOE OIP Letter at 11.

¹³ See ISE Letter II at 2-3.

¹⁴ Although ISE implies that it would draw *all* data inputs from Thursday data, CBOE assumes that ISE actually would use *Friday*, not Thursday, prices of the Trust’s stock holdings to calculate the NAV. If not, the settlement value of the Proposed Options would be fully determinable as of the start of trading on Friday, which would mean that investors could trade on Friday with precise knowledge of the settlement value at which the Proposed Options (continued)

example, by using Thursday data about the Trust's cash holdings, ISE would ignore any cash events that occurred on Friday, including dividends the Trust received from stocks in the portfolio, the receipt of redemption proceeds, and the accrual of Trust expenses.

Even more importantly, ISE would not account for any changes that S&P might make to the weightings of the constituent stocks in the S&P 500 index on that Friday. S&P makes such an adjustment on at least a quarterly basis, when it does its quarterly rebalancing of the weightings of the stocks in the S&P 500 Index. Whenever S&P makes material adjustments to those weightings, the trustee of the SPDR Trust makes comparable changes to the Trust's holdings.¹⁵ Both this quarterly rebalancing of the S&P 500 Index and the corresponding adjustments to the holdings in the SPDR Trust are done on expiration Fridays and would be reflected in the Trust's official NAV as of the close of trading on that Friday. However, because ISE would use stale information from Thursday, ISE's recalculated NAV would not reflect those potentially material changes.

In short, the settlement value of the Proposed Options would not actually be based on the NAV of the SPDR Trust. At best, it would be based on a pale estimate of that NAV, which would be demonstrably, and often materially, incorrect. For these reasons, the ISE Proposal would lead to unacceptable investor confusion and risk.¹⁶

In its ISE OIP Letter, ISE makes an astounding claim: "We could not have been clearer in describing how the settlement value for Max SPY Options will be calculated."¹⁷ This is simply untrue. Over the course of the comment process, ISE has reluctantly dribbled out information about the mechanics of determining the settlement value for the Proposed Options. Even when forced to be specific, ISE's description of that process has been confusing, inadequate, incomplete and contradictory.¹⁸ As demonstrated above, the ISE OIP Letter only makes that situation worse. The Commission should not approve a product where the product definition and design is so dramatically in flux and so sloppily described. As the Commission has emphasized, the "calculation of the settlement value for the new derivative securities product should be *clear, fixed and objective*," and those matters should be addressed with clarity in the

would settle upon expiration. Trading under such circumstances would be artificial and could only harm those uninformed investors who were unaware that the settlement value of the Proposed Options already was determinable. Nevertheless, this lack of clarity regarding the inputs is yet another example of why the ISE proposal is ill-defined and inconsistent with the Securities Exchange Act of 1934.

¹⁵ See Prospectus for SPDR® S&P 500® ETF Trust, dated January 25, 2012, at 3 (the Trustee adjusts the Trust assets "to conform to periodic changes in the identity and/or relative weightings" by S&P of the stocks in the S&P 500 index). A copy of the current SPY ETF prospectus can be accessed at: <https://www.spdrs.com/library-content/public/SPY%20Prospectus.pdf>.

¹⁶ For the reasons stated in the CBOE OIP Letter, most investors would incorrectly believe – and would be induced to believe – that the Proposed Options would be based not on the NAV, but on the published value of the so-called Max SPY Index. See CBOE OIP Letter, Section III, at 12.

¹⁷ ISE OIP Letter, p. 1.

¹⁸ See CBOE OIP Letter at 11.

Ms. Elizabeth M. Murphy

August 27, 2012

Page 4 of 4

rule filing itself.¹⁹ The OIP process has identified material defects in the ISE Proposal, and CBOE believes that several of them cannot be remedied. If ISE disagrees, however, it should be required to address the concerns in a revised rule filing proposal, not in an ever-shifting series of positions taken over the course of multiple comment letters.

CBOE appreciates the opportunity to provide these comments. Should you require any further information, please contact the undersigned at (312) 786-7088 or Jenny Klebes-Golding, Senior Attorney, at (312) 786-7466.

Sincerely,



Edward T. Tilly

President and Chief Operating Officer

Chicago Board Options Exchange, Incorporated

cc: Robert Cook, Director, SEC Division of Trading and Markets
James Burns, Deputy Director, SEC Division of Trading and Markets
Heather Seidel, Associate Director, SEC Division of Trading and Markets
Richard Holley, Assistant Director, SEC Division of Trading and Markets
John Roeser, Assistant Director, SEC Division of Trading and Markets
Victoria Crane, Assistant Director, SEC Division of Trading and Markets

¹⁹ See Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952, 70960 (Dec. 22, 1998) (amending rule filing requirements for self-regulatory organizations regarding new derivative securities products and requiring settlement valuations methodology even in filings for derivatives products that become effective on filing) (emphasis added).